G. A Number Of Benefits Provided By SWBT Are Covered By the SFAS-106 Accounting Rules.

The types of benefits provided to retirees which comprise SFAS-106 costs are:

- Medical
- Dental
- Life Insurance
- Telephone Concessions

Summaries of SWBT's plan descriptions are attached as Exhibit 5.

H. For 1991 And 1992, SWBT's Pay-As-You-Go Levels Of Expenses Associated With SFAS-106 Benefits Are Reasonable.

The pay-as-you-go levels of expenses for 1991 and the estimated expenses for 1992 are as follows:[32]

SWBT 1991 Pay-As-You-Go Expenses

	(000's)
Medical	$ 88,614
Dental	$ 6,324
Life Insurance	$ 142[33]
Telephone Concessions	$ 1,700
Total Current Accounting	$ 96,780

[32]These amounts are for total SWBT operations and are not interstate-only amounts.

[33]Expenses for life insurance benefits are not literally pay-as-you-go. They are accrued and funded on an actuarially determined basis.

SWBT 1992 Pay-As-You-Go Estimates

	(000's)
Medical	$116,666[34]
Dental	$ 7,916
Life Insurance	$ 0[35]
Telephone Concessions	$ 2,102
Total Current Accounting	$126,684

I. The Two Funding Mechanisms Established By SWBT Prior To The Adoption Of SFAS-106 Are Not Relevant To The Exogenous Cost Calculation.

SWBT has previously utilized two funding mechanisms to pay for OPEBs, but neither of these are relevant to SWBT's SFAS-106 exogenous cost calculation. SWBT does not currently fund a VEBA[36] Trust for OPEBs.

[34]The increase in pay-as-you-go medical and dental expense reflects an increase in the retiree population of approximately 3,500 due to the SWBT management downsizing and approximately 1,700 due to the SWBT nonmanagement downsizing that occurred at the end of 1991 and during early 1992. This effect alone represents an approximate 17% increase in the relevant retiree population.

[35]In 1992 it is estimated that no additional expense related to life insurance benefits will be incurred due to the offset provided by prefunding.

[36]A Voluntary Employees' Beneficiaries Association (VEBA) is a tax exempt organization which is allowed to accumulate income producing reserves for the payment of life, sickness, accident and other similar welfare benefits (for both active and retired employees) on a tax free basis if it meets the requirements of Regulation Section 1.501(c)(9)-3(e). Internal Revenue Code (IRC) Section 419(b) permits a contribution deduction in an amount equal to the actual welfare benefit expenses incurred for the taxable year, plus an amount necessary to fund the various reserves for benefit claims incurred but unpaid as of the end of the taxable year.

1. <u>Quarterly VEBA for Medical Claims</u>

In December 1987, SWBT established a VEBA which was used to pay current medical claims for retirees and active employees. The funding of this VEBA in no way altered SWBT's method for recording benefit expense which was still based on the pay-as-you-go method. When cash was paid out of the VEBA, benefit expense was recorded.

Funding of current medical claims for retirees through this VEBA was discontinued in March 1992 and will not be relevant when SWBT elects to adopt SFAS-106. Even had SWBT continued to fund this VEBA, it would have had no effect on incremental expense related to OPEBs or on any interstate revenue requirements as mentioned previously.

2. <u>Life Insurance Funding</u>

Prefunding group life insurance benefits for retired employees was implemented in 1980 when SWBT recognized that life insurance benefits were similar to pension benefits and determined that provisions should be made to fund these costs during the working lives of the employees. The primary purposes of advance funding were:

(1) to allocate the costs of the benefits on a rational and systematic basis to periods in which the ratepayers benefitted

(2) to provide security for the employees by making receipt of the promised benefits independent of what happened to SWBT, and

(3) to assure investors that provisions were made to meet future liability entailed by these costs that could otherwise jeopardize their interests.

The amounts contributed to the Plan to cover these costs were actuarially determined, first by AT&T's actuaries prior to and immediately after Divestiture and subsequently by the actuarial firms of William M. Mercer, Inc. for the years 1986-1990 and Towers, Perrin, Forster and Crosby (TPF&C) for 1991 and 1992.

J. <u>To Date, SWBT Has Adopted A Minimal Amount Of OPEB Accrual Accounting</u>.

For all postretirement benefits with the exception of life insurance benefits, the accounting for regulatory and financial reporting has been the "pay-as-you-go" or "cash basis". For postretirement life insurance benefits, the annual cost has been computed for regulatory and financial reporting by SWBT's actuaries, TPF&C, using the aggregate cost actuarial method. Costs computed on this basis were used to determine the annual contribution to the life insurance fund. This process was as follows:

1) On the actuarial valuation date, the actuarial present value of future normal costs was determined as the excess of the actuarial present value of projected benefits over the actuarial value of plan assets. The actuarial present value of future normal costs was then divided by the actuarial present value of future valuation pay to determine the normal cost accrual rate.

   The normal cost accrual rate was multiplied by the valuation pay of active employees included in the actuarial valuation whose attained ages are less than the assumed retirement age to determine the normal cost for the valuation year. The actuarial cost methods was used to translate the calculated value of the future benefits into annual costs.

2) No unfunded actuarial accrued liability was

developed.

3) The actuarial gain (loss) was a measure of the difference between actual experience and that expected based upon the actuarial assumptions between two actuarial valuation dates. Under this actuarial cost method, the actuarial gains (losses) reduce (increase) future normal costs.

The actuarial valuations are performed in accordance with Sections 419 and 419A of the Internal Revenue Code which allow deductions for cash additions to a prefunding account, as long as these additions do not cause the assets in the account to exceed incurred claims plus a level-funding actuarial reserve for these benefits. In compliance with the Tax Reform Act of 1984, the actuarial valuation excludes liabilities for key employees and benefits in excess of $50,000 for any employees.

The life insurance amounts shown above are accrued and funded on an actuarial basis, rather than on a pay-as-you-go basis. For SWBT, these amounts were $602,000 in 1990 and $142,000 in 1991. The interstate portions of these relatively small amounts were the only postretirement nonpension benefits accounted for on an accrual basis that were included in SWBT's interstate revenue requirements as price cap regulation was adopted.

K. <u>No SFAS-106-Type Expenses Reflected Were Reflected In SWBT's Starting Interstate Rates for Price Cap Regulation or in SWBT's Current Interstate Rates</u>

SWBT has not previously reflected any SFAS-106-type[37]

[37]For purposes of this response, SWBT defines SFAS-106-type expenses as postretirement benefits accounted for on an accrual basis in accordance with the provisions of SFAS-106.

expenses in the interstate ratemaking process. No SFAS-106-type expenses were reflected in SWBT's interstate access rates that formed the basis for initial rates for price cap regulation. Similarly, no SFAS-106-type expenses have been included in any subsequent exogenous treatment and none are reflected in SWBT's current interstate rates.

While a minimal level of expenses associated with providing life insurance benefits to retirees has been determined by an accrual method, these amounts are not SFAS-106-like and have been explicitly excluded from SWBT's calculation of the appropriate exogenous cost adjustment for SFAS 106. Expense for life insurance benefits calculated by this accrual method, along with the pay-as-you-go amounts for the other benefits provided by SWBT, have been subtracted from SFAS-106 costs in computing incremental SFAS-106 expenses.

VII. <u>SWBT'S ASSUMPTIONS IN COMPUTING THE EXOGENOUS COSTS ARE REASONABLE</u>.

The following descriptions of the actuarial assumptions used by SWBT in calculating its OPEB obligation and accrual basis costs show that SWBT's exogenous cost amounts are reasonable. The specific assumptions are detailed herein and attached as Exhibit 6.

A. <u>Time Value Of Money</u>

The discount rate used in the actuarial study was 7.5% per year, compounded annually. This rate was developed in compliance with the provisions of paragraph 31 of SFAS-106 and was made in reference to the return on high-quality fixed-income investments currently available which have cash flows that match the timing and amount of expected benefit payments, as required by SFAS-106.

The rate is the same as that used in SWBT's pension calculation and reflects SWBT's best judgment with regard to the appropriate time value of money over the period.

B. Participation Rates

SWBT has a contributory plan, in that the plan has a defined dollar benefit cap per retiree which when exceeded in any given year (beginning 1993) will trigger retiree contributions. The participation rate used in the valuation is 100% based on SWBT's current experience. This participation rate assumption will be reviewed in the future as more experience under the benefit cap becomes available, as required under SFAS-106 and GAAP. The defined dollar benefit cap has been accounted for in the actuarial analysis and has reduced the total SFAS-106 expense.

C. Retirement Age(s)

The retirement assumptions used by SWBT are reasonable because they were based on SWBT's 1991 six-year experience study (covering the period 1985-1990), modified to reflect 100% retirement when first eligible after age 65, as required by SFAS-106. Specific assumptions are enumerated in Exhibit 6, pp. 9-10.

D. <u>Per Capita Claims Cost By Age</u>

The per capita claims cost by age used by SWBT are reasonable because they are based on a detailed evaluation of SWBT's recent experience. Specific assumptions are contained in Exhibit 6, pp. 1, 3-4.

E. <u>Health Care Cost Trend Rates</u>

Short-term health care cost trend rates are reasonable because they are based on recent SWBT retiree-specific experience. In 1992 health care inflation is assumed to be 13% to 14%. Intermediate-term health care cost trend rates (1993-99) assume a reduction of approximately 1% per year until reaching 6% in the year 2000. Long-term health care cost trend rates are set at 6% in a comparable manner to total spending in the U.S. economy (as measured by nominal gross domestic product) which is assumed to grow at 5.5%. Thus, SWBT's assumptions portray a highly significant curtailment of health care inflation rates.

F. <u>Salary Progression</u>

The only SWBT retiree benefit which is pay related is life insurance. Therefore, salary progression data are irrelevant to the vast majority of SWBT's SFAS-106 cost calculations. For use with the life insurance analysis, SWBT has based its salary progression on SWBT's 1991 five-year experience study (covering the period 1986-1990). Specific assumptions are contained in Exhibit 6, pp. 13-14.

G. Probability Of Payment

The probabilities of payment used by SWBT are reasonable because they are based on standard mortality and withdrawal tables reflective of tables weighted by SWBT's own experience. Specific table assumptions are illustrated in Exhibit 6, pp. 5-8, 11-12.

H. Capping Or Elimination Of Benefits

The actuarial study assumes a health care defined dollar benefit cap per plan participant. Future changes to the cap levels would require adjustment to SFAS-106 expense in the year of such changes in accordance with the provisions of SFAS-106. SWBT will modify expense levels in future years based on changes to the benefit caps over time, should they occur.

The actuarial valuation of SFAS-106 expense does not otherwise assume any future elimination or major reduction of postretirement benefits. If any such eliminations or reductions do occur, SWBT will make the necessary adjustments to SFAS-106 expense at the appropriate time as required in the SFAS-106 statement and GAAP.

I. Possible Advent Of National Health Care Insurance

SWBT did not assume the advent of national health care insurance. Changes in Medicare or the initiation of a national health care insurance plan would affect a quantification of both pay-as-you-go and SFAS-106 accrual accounting for OPEBs. Given the highly speculative nature of these changes, any such assumption was deemed inappropriate and could not be reasonably quantified. SWBT would modify quantification of OPEB amounts due to any such changes in compliance with SFAS-106 and GAAP.

VIII. NO ADDITIONAL ADJUSTMENTS ARE NEEDED TO AVOID DOUBLE COUNTING IN GNP-PI DUE TO GROWTH IN MEDICAL CARE COSTS.

The _Investigation Order_ requested "a discussion of adjustments that should be made to avoid double counting in GNP-PI given that growth in medical care costs causes growth in GNP-PI."[38] No such adjustment is required.

Inflation in medical care costs is present in the projected pay-as-you-go OPEB costs. As a result, the effect of growth in medical care costs on GNP-PI, if any,[39] is already reflected in the base pay-as-you-go OPEB costs. In SWBT's analysis, the incremental SFAS-106 cost estimates utilize the exact same medical care inflation rates as included in the base pay-as-you-go estimates. SWBT is not requesting exogenous cost treatment for medical care inflation, rather SWBT has isolated the incremental interstate revenue requirements caused by the accounting change alone. Thus, the method used by SWBT to calculate the exogenous cost adjustment results in _no_ double counting associated with growth in medical care costs.

---

[38] _Investigation Order_, para. 15.

[39] Most thoughtful analysts of inflation would conclude that overall inflation (as reflected in GNP-PI) is caused by monetary policy, not by changes in the relative cost of medical care. Overall inflation is then apportioned to specific sectors of the economy based on relative pressures within each sector.

IX. THE EXOGENOUS COST ADJUSTMENT CALCULATED BY SWBT SHOULD NOT BE ALTERED FOR ANY WAGE CHANGE EFFECT.

Paragraph 15 of the Investigation Order requests discussion of the need for an adjustment to the proposed exogenous cost change to account for any wage changes expected to occur as a result of SFAS-106. Under SWBT's proposal, no adjustment is needed. The Godwins Study explicitly identifies the very limited extent to which SFAS-106 costs are included in GNP-PI. A 0.7% recovery due to this effect is estimated. This leaves 99.3% of SFAS-106 costs to be recovered through means other than GNP-PI.

Nevertheless, SWBT, very conservatively, plans to use the estimated 0.9% reduction in relative wage rates in the Godwins Study to reduce its requested SFAS-106 exogenous cost adjustment by an additional 14.5%. This approach is not mandated by the Commission rules, and SWBT may amend this approach when it actually files its tariff to formally request exogenous cost recovery, based upon comments received in this docket and the most current data available at that time.

X. SFAS-106 COSTS ARE NOT REFLECTED IN THE OTHER EXOGENOUS COST ADJUSTMENTS ALREADY ALLOWED.

SWBT's SFAS-106 related costs have not been reflected in any of the exogenous cost changes already included in SWBT's current or pending tariff filings. Further, SFAS-106 costs will not be directly reflected in future exogenous cost changes unless specifically approved by the Commission.

SWBT has included exogenous costs changes in its 1991 and

1992 Annual Tariff Filings, as prescribed in Section 61.45 of the Commission's Rules.[40] These exogenous cost changes include:

(1) Completion of the amortization of depreciation reserve deficiency [Section 61.45(d)(1)(i)].

(2) Changes in the Separations Manual attributable to alterations in SWBT's Subscriber Plant Factors (SPF) and Dial Equipment Minute (DEM) factors. [Sections 61.45(d)(1)(iii) and (d)3].

(3) Changes to SWBT's Long Term Support Fund and Transitional Support Fund obligations [Section 61.45(d)(1)(iv)]

(4) Changes in excess deferred taxes and investments tax credit amortization. [Section 61.45(d)(1)(vi)]

(5) Completion of the amortization of embedded inside wire. [Section 61.45(d)(1)(viii)]

The historical base period costs used to quantify these impacts for the annual access tariff filings did not include any SFAS-106 costs. Consequently, there are no such costs included in SWBT's exogenous cost changes filed to date.

For future periods, SFAS-106 costs will not be directly included in any other exogenous cost changes. Some small amount of indirect effects on other future exogenous cost adjustments may result, but such indirect effects are warranted.[41]

---

[40] 47 C.F.R. § 61.45.

[41] For the remaining exogenous cost adjustments that would be indirectly affected, if any, the indirect effect may be warranted. An example would be the effect of SFAS-106 on a future separations rule change. Presume a reduction in an interstate separations ratio caused by a Part 36 rules change that occurs after adoption of SFAS-106. Recall that SFAS-106 will increase total expenses subject to separations with or without exogenous cost treatment of SFAS-106. With a higher base of expenses, a future separations exogenous cost flow through will result in a larger reduction in (continued...)

However, these indirect effects will be negligible for the following reasons. Most of the major exogenous cost changes are expiring and will not have any effects or only minimal effects in subsequent annual filings. In fact, inside wire and reserve deficiency amortizations, and the SPF and DEM separations transitions are all to be completed by 1993 or earlier. In addition, the excess deferred tax and unamortized investment tax credit exogenous adjustments are historical amounts and will never be affected by SFAS-106. Thus, no modification to the SFAS-106 amounts to reflect other allowed exogenous cost adjustments are warranted.

XI. THE MACROECONOMIC MODEL RELIED UPON BY SWBT IS APPROPRIATE.

SWBT will rely upon the macroeconomic model contained in the Godwins Study. The model was constructed so that it could be checked and verified by commentors. The documentation provided with the model[42] demonstrates its reasonableness and answers the questions posed by paragraph 16 of the Investigation Order.

---

[41](...continued) the price cap index(es) than would otherwise be the case. This is most probably the intended result.

[42]See Exhibit 1, infra., at pp. 23-33, 54-59. In addition, in response to the questions posed by paragraph 16 of the Investigation Order, Godwins prepared Exhibit 7, which is attached hereto and which SWBT understands will also be filed with USTA's Direct Case in this docket.

XII. CONCLUSION.

Based upon the Commission's prior orders, SWBT has fully expected exogenous cost treatment for the effect of this GAAP change. Such treatment is consistent with the Commission's policies toward carriers already obtaining rate recovery for OPEB accrual accounting and toward other allowed exogenous cost changes. To deny such treatment would be arbitrary and capricious. Further, SWBT's calculations in figuring the amount of the exogenous cost change are reasonable. Thus, the Commission should recognize the change in accounting necessary for implementation of SFAS-106 as an exogenous cost change.

Respectfully submitted,

SOUTHWESTERN BELL TELEPHONE COMPANY

By ______________________

Durward D. Dupre
Richard C. Hartgrove
Thomas A. Pajda

Attorneys for
Southwestern Bell Telephone Company

1010 Pine Street, Room 2114
St. Louis, Missouri 63101
(314) 235-2507

June 1, 1992

EXHIBIT 1

Southwestern Bell Telephone Company Direct Case
CC Docket No. 92-101

USTA Analysis of Impact of SFAS 106 Costs on GNP-PI
Prepared by Godwins, February 1992

UNITED STATES TELEPHONE ASSOCIATION

Analysis of Impact of SFAS 106 Costs on GNP-PI

February, 1992

Godwins

BACKGROUND

Godwins has been engaged by the United States Telephone Association to perform an analysis of the impact of SFAS 106 on the GNP-PI. In particular, Godwins was asked to determine the extent to which the price cap mechanism utilized by the FCC will reflect the impact of SFAS 106 and will enable Local Exchange Carriers to recover their increase in total operating costs incurred due to their adoption of the new accounting standard.

This report describes the results of that analysis and provides detailed documentation of the data, methods, and assumptions utilized in the study.

Respectfully submitted,

Peter J. Neuwirth, F.S.A., M.A.A.A.

Andrew B. Abel, Ph.D.

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY

The purpose of this study is to determine what percentage of the additional costs incurred by Local Exchange Carriers subject to Federal Price Cap regulations (hereinafter referred to as "Price Cap LECs") as a result of the Financial Accounting Standards Board's Statement No. 106 (SFAS 106) will be reflected in the GNP Price Index (GNP-PI) and what percentage will not be so reflected.

This study finds that ultimately the increase in GNP-PI caused by SFAS 106 will provide for recovery of 0.7% of the additional costs incurred by Price Cap LECs. Other macroeconomic factors, principally an eventual adjustment of the national wage rate, account for recovery of an additional 14.5% of the additional costs incurred by Price Cap LECs, leaving 84.8% of these additional costs unrecovered.

This study is presented in two stages: an Actuarial Analysis followed by a Macroeconomic Analysis. The Actuarial Analysis uses demographic, economic and benefit program data collected from each Price Cap LEC to construct a composite company (hereinafter referred to as "TELCO") which reflects the characteristics of the industry as a whole. This analysis finds that the impact of SFAS 106 on the costs of the average employer in the economy is only 28.3% of the corresponding impact on TELCO. The Macroeconomic Analysis which analyzes the impact of SFAS 106 on the economy as a whole finds that only 2.3% of the average employer's additional costs resulting from SFAS 106 is passed through to the GNP-PI.

The table on the following page summarizes how the key results of the study are combined to derive the unrecovered proportion of the Price Cap LECs' SFAS 106 costs.

Effects of SFAS 106 on TELCO's Costs

(A)	Impact on national average costs relative to TELCO's costs (from the Actuarial Analysis)	28.3%
(B)	Proportion of increase in national average costs passed through to GNP-PI (from the Macroeconomic Analysis)	2.3%
(C)	Proportion of TELCO's SFAS 106 cost increase reflected in GNP-PI (item (A) x item (B))	0.7%
(D)	Proportion of TELCO's SFAS 106 cost increase offset by other macroeconomic adjustments, including the reduction of the wage rate (from the Macroeconomic Analysis)	14.5%
(E)	Proportion of TELCO's SFAS 106 cost increase unrecovered (100% - item (C) - item (D))	84.8%

Actuarial Analysis

Even if one were to take a conservative approach and assume that all SFAS 106 costs were passed through directly and completely to price increases and thus into the GNP-PI, 100% of each Price Cap LECs SFAS 106 costs would be reflected in the GNP-PI, only if the following were true:

- The benefits provided by the Price Cap LEC to its employees were at the same level as those provided to all other employees in the economy.

- The benefits provided by the Price Cap LEC gave rise to the same relative increase in total costs as for other employers when SFAS 106 is applied.

Because neither of the above statements is true the percentage of each Price Cap LEC's SFAS 106 costs that will be reflected in the GNP-PI is far less than 100%. Indeed, we have determined that ignoring macroeconomic effects, only 28.3% of the additional costs incurred by the average Price Cap LEC due to SFAS 106 will be reflected in the GNP-PI. This result was derived by the following steps:

- By utilizing demographic, economic, and benefit program data collected from each Price Cap LEC we constructed a composite company (hereinafter referred to as "TELCO") which reflects the characteristics of the industry as a whole.

- By utilizing a data base of plan provisions for retiree medical plans sponsored by 830 private sector employers (covering 19 million employees) and our Benefit Level Indicator ("BLI") methodology, we determined how TELCO's program compared to a "national average" benefit program.

- We adjusted this comparative benefit analysis to reflect specific factors that would cause similar benefit programs to generate different levels of SFAS 106 cost. In particular, we adjusted for:

  - differences in demography (average age, service, etc.)
  - differences in withdrawal and retirement patterns
  - differences in the number and impact of current retirees
  - differences in the extent of current pre-funding of benefits conducted by TELCO and that of others.

- We then took account of the very large group of workers in the national economy who are not covered by any post-retirement program or are covered by a program that is not affected by the FASB's rules. Their employers will, by definition, incur no SFAS 106 cost for them.

- We made two final adjustments to the comparative analysis due to economic factors. In particular, we:
  - made an adjustment for differences between per unit labor costs for TELCO and for other employers, and
  - made an adjustment for differences in the percentage of total output represented by labor costs for TELCO and for other employers.

Putting together all of these factors, we find that the impact of SFAS 106 on the costs of the average employer in the economy (including employers that do not offer post-retirement health benefits and/or are not affected by FASB's rules) is only 28.3% of the corresponding impact on TELCO. In addition, the Actuarial Analysis finds that SFAS 106 directly increases labor costs by 3% for the average employer offering post-retirement health benefits covered by SFAS 106. This 3% figure is an important input to the Macroeconomic Analysis.

Macroeconomic Analysis

The purpose of the Macroeconomic Analysis is to determine the extent to which the additional costs resulting from SFAS 106 would be passed through to an increase in GNP-PI. The Macroeconomic Analysis utilizes a macroeconomic model developed for Godwins by Professor Andrew Abel of the Wharton School of the University of Pennsylvania to address this question. The Macroeconomic Analysis finds that only 2.3% of direct SFAS 106 costs of the average employer in the economy are passed through to the GNP-PI. In addition, as a result of SFAS 106 the average wage rate in the economy would be 0.93% lower than it would have been in the absence of SFAS 106.

Effects of SFAS 106 on TELCO's Costs

As noted, the ultimate purpose of the study is to determine the extent to which GNP-PI reflects the additional costs incurred by the average Price Cap LEC (i.e. TELCO) as a result of SFAS 106. The table shown on page 2 summarizes our findings. Item (A) summarizes the Actuarial Analysis which finds that costs of the average company in the economy increase by only 28.3% as much as TELCO's costs increase as a result of SFAS 106. Because only 2.3% of the average increase in costs is passed through to the GNP-PI (item (B)), only 0.7% (item (C), 2.3% x 28.3%) of TELCO's additional costs resulting from SFAS 106 are reflected in GNP-PI. Thus, it would appear that 99.3% of TELCO's additional costs are left unrecovered. However, the Macroeconomic Analysis finds that the national wage rate would be 0.93% lower than it would have been in the absence of SFAS 106. If TELCO were able to benefit from a similar reduction in its wage rate, such a reduction would recover an additional 14.5% of TELCO's direct SFAS 106 costs (item (D)). Taking account of the 0.7% recovery due to GNP-PI and the 14.5% recovery due to the adjustment of the wage rate leaves 84.8% of TELCO's direct SFAS 106 costs unrecovered (item (E)).

II. DEVELOPMENT AND SUMMARY OF RESULTS

We wish to establish what percentage of the average Price Cap LECs SFAS 106 costs will be reflected in the GNP-PI and hence what percentage will not be so reflected.

We begin with an actuarial analysis which proceeds in two steps. The first step in the actuarial analysis is to construct a composite company which accurately reflects the characteristics and benefit plans of the average Price Cap LEC. The second step is to determine the impact of SFAS 106 on this composite company relative to the impact of SFAS 106 on other employers in the GNP on the assumption that all additional costs are passed on completely into the GNP-PI. Following the actuarial analysis is a macroeconomic analysis to determine the extent to which the additional costs will, in fact, translate into higher prices and, therefore, affect the GNP-PI.

Construction of Composite Company ("TELCO")

Actuarial, benefit, economic and demographic data were collected on eleven Price Cap LECs. Data included was for total Telephone Operations consistent with amounts included on the 1990 ARMIS 43-02 for each Company. These data were then combined, treating each Price Cap LEC as if it were a division of the larger combined company. The characteristics of this composite company ("TELCO") are as follows:

Number of Active employees	613,193
Number of Retired employees:	294,482
1990 Average compensation per employee:	$38,533
1990 Total Revenue (in millions):	$82,512.9
1990 Total Value Added (in millions):	$61,338.4
Average Per Capita Claims Cost:	$3,075
Average Age of Actives:	41.6
Average Service of Actives:	16.6

Impact of SFAS 106 on the Average Price Cap LEC Relative to its Impact on All Employers in the GNP

There are 95.8 million private sector employees and 18.6 million public sector employees in 'GNP', all of whom (and their dependents) may incur medical charges in retirement. Public sector employers, however, will not record SFAS 106 expense even where the entity sponsors a post-retirement medical plan (public sector employers are not subject to FASB rules).

Of the private sector employees, 30.7 million are eligible to have a proportion of their charges in retirement met by their employer's medical plan (and which plan is subject to SFAS 106), the actual proportion depending on the detailed provisions of their employer's plan(s). It is this anticipated employer cost for those employees that is reflected in SFAS 106 costs. The proportion of the charges met is an effective measure of the overall level of benefit provided by a given plan. We will refer to it as the Benefit Level Indicator ("BLI"). We must establish the average proportion of covered employees' charges that will be met collectively by their employers - the GNP BLI.

Separately we will calculate the average proportion of charges met by the average Price Cap LEC - the TELCO BLI.

All other factors being equal (which they are not), the percentage of TELCO's SFAS 106 costs that would be reflected in the GNP-PI would be represented by the following ratio:

$$\text{BLI Ratio} = \frac{\text{GNP BLI}}{\text{TELCO BLI}} = \frac{\text{Benefit Level Indicator for the average employer in the GNP}}{\text{Benefit Level Indicator for TELCO}}$$

However, this ratio requires a number of adjustments:

- Adjustment for differences in demography which will affect the SFAS 106 impact of a given program (Demographic Adjustment).